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SUBJECT: Mongolian Mining Exec: Promise, Peril Surround Sector

Reftel: Ulaanbaatar 0217

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11. (SBU) SUMMARY: The Ambassador discussed Mongolia's promising but politically-charged mining sector on September 4 with Dashdorj Zorigt, CEO of Erdenes MGL, a new mining-asset holding company that is state-owned. Over an informal dinner, discussion flowed on the status and future of Erdenes (EM), which Zorigt said is working with international consultants to create a company that is transparent, free from government interference and based on western best practices. The CEO said political jockeying and showmanship before the June 2008 elections are threatening to scuttle the Oyu Tolgoi deal. He added that with enough provocation, western firms might pull up stakes and leave Mongolia, creating a vacuum that the Russians and Chinese would quickly fill. Such an outcome would have disturbing implications for Mongolia's economy and democracy. END SUMMARY.

12. (SBU) The Ambassador, joined by Econoff and Commoff, hosted Erdenes MGL CEO D. Zorigt for dinner on September 4. The Ambassador congratulated Mr. Zorigt on his selection as his company's first CEO. Zorigt observed that pity -- not congratulations -- might be in order, given the political, economic and social consequences of running a company that might well control assets worth billions of USD. Zorigt then launched into a detailed review of the firm's current status and future plans.

JOB ONE: MANAGING MINING ASSETS

13. (SBU) The GOM set up EM in early 2007 to serve as a holding

company to manage mining assets that Mongolia might acquire under the recently amended Minerals Law of Mongolia (reftel), which allows the state to acquire up to 50% of shares in strategic projects. (Note: "Strategic" is loosely defined as having some large-scale impact on the Mongolian economy or society. However, there is no official definition. End Note.)

14. (SBU) According to Zorigt, the GOM created the company primarily to generate revenue for direct cash transfers to the people of Mongolia: welfare payments to children, new mothers, newly married couples, etc. The firm will also manage and invest the mineral revenues of Mongolia for long-term wealth generation, investment and development, along the lines of the Norwegian or Alaskan models. EM's founders envision the company as a mining giant, similar to such state-owned mining firms as Brazil's CVRD or French uranium miner Arreva (formally COGEMA).

LEARNING FROM THE PROS

15. (SBU) Zorigt admits that these are heady ambitions for a firm that currently lacks assets, a formal business plan, a clear corporate structure, or an explicit mandate from the GOM. Zorigt laid out his strategy for achieving these ends. First, Zorigt and his team are in the process of acquiring the services of such professional consultancies as John Thornton, McKenzie, and JP Morgan Chase. Seeking funding from the World Bank, Zorigt intends Thornton to advise on a business plan; McKenzie to craft EM's corporate structure; and JP Morgan Chase to advise EM and the GOM on negotiating specific mining deals and organizing tenders for state-owned assets.

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16. (SBU) Zorigt wants a legal framework and a corporate structure that allow EM to function as a commercial entity, without the political interference that has plagued other state-owned firms in Mongolia. This approach is necessary, he argues, because EM must not be run by GOM bureaucrats or local Mongolian business people whose narrow, local interests will always trump fiduciary responsibilities to the shareholders: the people of Mongolia.

17. (SBU) Drawing on his consultations with the U.S. firms, Zorigt has drafted legislation that is slowly making its way through the GOM and Parliament. His bill would create a board of directors independent from direct state control, which would specifically exclude GOM bureaucrats (or at least statutorily deny GOM officials a majority of seats on the board). The enacting legislation would also require that senior executives be retained through an international search and be compensated at an international level. Zorigt recognizes that this legislation will be a hard sell, but believes he has sufficient support for it among an effective voting majority. He hopes for passage in fall 2007.

MINING DEBATE TURNS SOUR

18. (SBU) Regarding the politics of mining in Mongolia, Zorigt worries about the "de-evolution" of the debate over mining and its implications for the long-term security of Mongolia's democracy and economy. He noted that the Democratic Party has placed itself in firm opposition to approving the Oyu Tolgoi Investment Agreement in its current form. Zorigt agrees in principle with some of the Democrats' arguments against the existing deal, noting that several tax exemptions could be scaled back without scuppering the entire deal. However, Zorigt noted that demands that the private rights holders give up additional equity to the GOM, so that the GOM will have 51% of the multi-billion dollar project, is a non-starter as far as the rights holders - mining giant Rio Tinto and Ivanhoe Mines - are concerned.

19. (SBU) Zorigt said parliamentary insistence on this 51% threatens the entire deal, and raises the ugly suspicion that certain MPs are putting politics ahead of national interest or worse, dealing in bad faith. Zorigt claimed that the Democratic Party (DP) is loathe to see the current MPRP-led government garner any success; and so,

rather than work with the current government to craft a deal more favorable to the GOM, and share some credit, the opposition would rather throw the entire deal out, claiming that it is defending Mongolia's honor. In other words: go for the dramatic, nationalistic punch in the run-up to the June 2008 elections for Parliament, rather than share moderate credit for key developments with the MPRP.

¶10. (SBU) We asked what would happen to the Oyu Tolgoi deal if the DP successfully stalled the deal until after the elections. Would the DP attempt to pass it if it comes to power, as some political observers expect? Zorigt thinks the DP might, but that it would encounter significant resistance from a unified MPRP opposition bloc, which would never allow the DP to pass a deal that the MPRP had first proposed. For this reason, he said, development on Oyu Tolgoi and other key developments would languish and Mongolia would not profit in any way.

POLITICS THREATENS TO CHASE AWAY WESTERN FIRMS

¶11. (SBU) Zorigt said he took his concerns to MPs who are leading

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Parliament's review of the Oyu Tolgoi deal, noting that Ivanhoe and Rio Tinto, as well as other western firms, would mothball projects and wait. The Democratic members countered that they would simply change the law to take the mining rights from the private holders and look for other investors. However, Zorigt said he thinks it will be nearly impossible for Mongolia to garner investment from any western source after violating the rights of Rio Tinto and other firms.

¶12. (SBU) If that is the case, we asked, who would finance the development? The Russians? The Chinese? Given public fears of domination by either state, we questioned how any MP could get away with proposing to convey these "national assets" to Russia or China.

Zorigt argued that if the Democratic opposition succeeds in wrecking the Oyu Tolgoi deal, politicians might be willing to sell, either to profit from Chinese or Russian enticements or to avoid the wrath of an angry Mongolian public.

DEVELOPMENT COULD BRING HUGE BENEFITS...

¶13. (SBU) Zorigt said development of the Oyu Tolgoi site alone would have a dramatic impact on Mongolia's economy, perhaps raising Mongolia's GDP by 50%. But more importantly, he said, developments at OT and other sites would lead to huge improvements in key Mongolian infrastructure areas such as water, power, roads, rail and aviation for years to come. He added that most of the capital flows, investments, insurance and other financial services would be tied to OT and other developments. These mines, he said, will become the heart of Mongolia's economy and have a profound effect on political and democratic developments.

... BUT DANGERS ALSO LURK

¶14. (SBU) But what if, Zorigt asked, these mines fall into Chinese or Russian hands? Those nations and their miners would then gain a stranglehold on Mongolia's economy and -- by extension -- national security. Mongolia would have little recourse in the face of such powerful neighbors, who could effectively "turn off the water or power" until Mongolia complied with their demands. Zorigt concedes that although Mongolian politicians' fear of China and Russia steers them toward western investment as a counterweight, it is not a foregone conclusion that national interest will trump short-term political gain and short-sighted self-interest.

COMMENT

¶15. (SBU) Zorigt's concerns about Mongolia's far larger neighbors has a factual basis. China has, on occasion, shut down access to Mongolia's most essential railway, to signal its disapproval of

Mongolia's policy on the Dali Lama. Russia, for its part, often cuts its supply of electricity to western Mongolia if bills are not paid on time.

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